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CIA-RDP85T00875R00170003

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CIA-RDP85T00875R00170003

CHIEF/IM 72-20

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**DIRECTORATE OF
INTELLIGENCE**

Intelligence Memorandum

Economic Prospects for West Pakistan

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ER IM 72-20
February 1972

Copy No. 79

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
February 1972

INTELLIGENCE MEMORANDUM

ECONOMIC PROSPECTS FOR WEST PAKISTAN

Introduction

1. West Pakistan's economic position and outlook have been altered considerably by the past year's events. As a result of the civil war in the East Wing, which began in March 1971, military expenditures increased sharply, foreign aid donors were alienated, and interwing economic ties were disrupted. The two-week war with India in December resulted in the destruction of a substantial part of Islamabad's modern weapons inventory and heavy damage to petroleum facilities in Karachi, as well as the loss of East Pakistan - now Bangladesh. A new government headed by Zulfiqar Ali Bhutto is shaping economic policies significantly different from those of the Ayub Khan and Yahya Khan regimes. This memorandum examines the economic consequences of the 1971 crises and assesses West Pakistan's economic prospects.

Summary

2. Loss of the East Wing and strained relations with the Western-Aid-to-Pakistan Consortium mean pronounced transitional difficulties for the West Pakistan economy. But given political stability and moderate policies, West Pakistan's long-term economic prospects are more favorable than those of India or Bangladesh. Loss of markets in East Pakistan and its net foreign exchange earnings will be less important than the fact that the West has been shorn of its poorest, most densely populated and economically stagnant region, which promised to be a growing claimant on foreign aid receipts and a declining net earner of foreign currency. West Pakistan is basically self-sufficient in foodgrain production, has a reasonably well-developed infrastructure, and is able to draw on a sophisticated entrepreneurial class. With its 6% growth rate in the 1960s, the West

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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demonstrated that it could marshal its resources fairly effectively, with financial help from abroad.

3. The civil war in East Pakistan and the short conflict with India had relatively small economic effects in West Pakistan. Physical damage was slight except for India's bombing of the Karachi oil facilities and a few other industrial plants. The fighting did, however, contribute to uncertainty among investors. At the same time, Islamabad began to shift some of its interwing exports to foreign markets and secure its control over Pakistan's total foreign reserves.

4. Islamabad's export and foreign aid prospects -- together with its present modest foreign reserves -- point to substantially reduced import capacity in fiscal year (FY) 1972⁽¹⁾ and only a partial recovery in FY 1973. Progress in redirecting interwing exports to foreign markets probably will permit West Pakistan to maintain, but not significantly increase, total exports during FYs 1972-73. Foreign aid receipts, on the other hand, are expected to drop sharply in FY 1972 because the aid consortium stopped making new extensions (except for relief shipments) in March 1971. Even if Islamabad can settle the debt renegotiation issue with the Consortium and arrange new assistance programs, it probably cannot expect gross aid receipts of more than \$450 million in FY 1973 -- about the amount received in FY 1971. Import capacity is likely to be about one-sixth lower in FY 1972 than in FY 1971 and to remain somewhat below the FY 1971 level the following year. Even if foreign reserves are drawn down appreciably and a moderate amount of stop-gap commodity aid is received soon, West Pakistan probably will not be able to import as much this fiscal year as last year.

5: Business uncertainty and weaknesses in some industries that had been exporting to the East probably will constrain West Pakistan's economic performance at least as much as reduced import capacity. Investors' confidence has been shaken by the regime's recent partial takeover of several industries and by its demand that funds held abroad be repatriated promptly. Output in some of the major plants is being disrupted by the change in management, and other industries are finding it difficult to quickly shift their former East Wing sales to foreign markets. Public investment activity was disrupted by military activities last year and now is apparently being held down by budget difficulties. Everything considered, we believe that there will be a small decline in West Pakistan's output in FY 1972. Economic performance in FY 1973 will depend heavily on the new government's policy direction and the generosity of aid donors.

1. The fiscal year ends 30 June of the stated year.

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CONFIDENTIAL**Discussion****Background**

6. Although much better off economically than Bangladesh, West Pakistan ranks among the world's poor nations, with an annual per capita output of some \$140. It is sparsely populated by South Asian standards, having an area about 20% larger than Texas and five times as many people. The nation still is basically agricultural. About 60% of the labor force is engaged in farming, and the manufacturing and services sectors are based largely on agriculture. Except for natural gas, the mineral resource base is small. West Pakistan is heavily dependent on imports to meet its energy requirements.

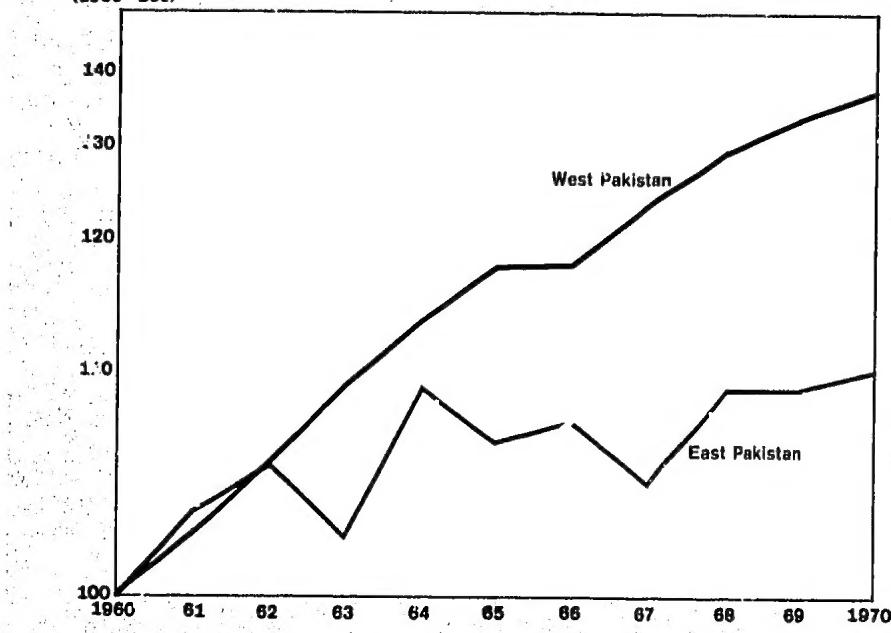
7. Economic growth was rapid during 1961-70, averaging about 6% annually. Although the rate of population growth was high, as in other South Asian areas, West Pakistan substantially raised output per capita and living conditions in the 1960s, in sharp contrast to East Pakistan (see the chart). A major factor in this accomplishment was the "Green Revolution" in agriculture, which resulted in large production gains and virtual self-sufficiency in foodgrains. The Indus Water Treaty with India in 1960 brought Islamabad considerable foreign assistance for public agricultural development. Private agricultural investment also rose sharply because the government instituted favorable price policies; liberalized imports of fertilizer, pumps, and other modern inputs; and spent heavily on infrastructure improvements.

8. Industrial development also has been impressive, yielding average production gains of 9% annually in the 1960s. Soon after British India's partition, Islamabad shifted from the export of raw cotton to the manufacture of cotton textiles for the local market, for its captive market in the East Wing, and for export abroad. By FY 1971 cotton textiles accounted for about one-fifth of industrial production and one-third of foreign sales. Although cotton textiles is the predominant industry, the most rapid growth occurred in such new industries as engineering goods and chemicals (especially fertilizers).

9. Underlying West Pakistan's economic growth in 1961-70 was an improved (although not sustained high) investment rate plus rapidly expanding imports of capital goods and raw materials. Both developments rested heavily on large aid inflows. During Pakistan's first decade, investment was seriously constrained by sluggish export growth and consequent foreign exchange shortages. Under President Ayub Khan (1958-69), foreign aid receipts increased sharply, reaching a peak of \$474 million in 1968. About two-thirds of the \$5-1/2 billion in economic aid received during these years

CONFIDENTIAL**West and East Pakistan:
Indexes of Per Capita Gross Provincial Product**

(1960=100)



Note: The fiscal year ends 30 June of the stated year.

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was used in West Pakistan and was a major factor in its superior performance compared with East Pakistan.

10. West Pakistan's import capacity between FY 1961 and FY 1971 benefited from a considerable growth in exports abroad and foreign aid and, in addition, from East Pakistan's net foreign exchange receipts. The West's foreign exports rose by about 250%, to \$420 million (see Table 1). Moreover, net foreign aid receipts remained large despite a marked rise in debt service payments, from \$12 million to \$132 million. Even with these advantages, West Pakistan was able to boost imports from abroad by about 70%, but only at the cost of continuing sizable foreign payments deficits. These deficits, totaling \$1.2 billion during the period, were covered fully by East Pakistan's foreign payments surpluses. The Islamabad government had these surpluses at its disposal and could at least partly justify using them in this way on the ground that West Pakistan had substantial surpluses in interwing trade.

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Table 1

West Pakistan:
Major Elements in the Balance of Payments

Fiscal Year	West Pakistan, Excluding Interwing Transactions				Million US \$	
	Imports a/	Exports a/	Net In- visibles	Estimated Net Foreign Aid b/	Foreign Payments Balance	East Pakistan's Estimated For- eign Payments Surpluses (Available to West Pakistan) b/
1961	443	118	-26	199	-139	+146
1962	482	119	-22	196	-178	+174
1963	589	207	-25	291	-104	+167
1964	617	217	-43	340	-89	+101
1965	690	239	-84	386	-139	+93
1966	603	250	-70	316	-95	+154
1967	770	265	-77	365	-204	+116
1968	766	314	-53	370	-121	+103
1969	613	344	-51	305	+6	+87
1970	676	328	-18	272	-95	+116
1971	757	420	-34	337	-34	+111
Total	7,006	2,821	-503	3,377	-1,192	+1,368

a. Based on foreign exchange control data except for 1971 which is based on customs data.

b. Assuming that West Pakistan received two-thirds of total Pakistani foreign aid receipts.

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11. Pakistan's budget showed considerable emphasis on economic development in the early 1960s, but these efforts lost ground to a military buildup in succeeding years. Increases in public investment averaging 20% annually between FY 1961 and FY 1965 were mainly responsible for the widening of the budget deficit from about 22% to 33% of total government expenditure. In the ensuing five years, the growth of revenues accelerated, but public investment increased by an average of only 5% annually, compared with a 17% average for defense spending. As a rule, Islamabad financed its deficit largely with foreign aid; in FY 1970, for example, bank financing was used to cover only 19% of the deficit.

Economic Impact of the Civil War

12. The civil war in the East that began in March 1971 had surprisingly little adverse effect on general economic conditions in the West. For one thing, the net West-to-East resource flow of recent years was stopped by the virtual halt in development expenditures in the East. Moreover, the loss of foreign exchange earnings caused by the falloff in the East's exports was more than offset by a decline in foreign imports into the East Wing and an increase in the West's foreign exports. Although East Pakistan's foreign exports during March-October fell by almost one-half (or \$95 million) from the same period in 1970, imports from abroad dropped by more than one-half (\$161 million). Meanwhile, a one-third drop in exports to the East Wing helped West Pakistan's foreign exports to increase by 25%, or \$62 million. Cotton textile sales to Hong Kong, Japan, and the United Kingdom increased, and raw cotton normally shipped to the East Wing for processing found ready markets in Hong Kong and Japan.

13. The major additional cost of the civil war to Islamabad was sharply increased expenditures to maintain more troops in the East and move other troops to forward positions along the Indo-West Pakistani border. By late November, the armed forces -- including security forces -- had been expanded about 20%, and costs were raised further by the enlarged supply problem. Since flights over India were prohibited, the 70,000 troops in the East Wing were 3,000 miles away via air or water from supply sources in the West. Redeployment of troops to the Indo-West Pakistani border involved refurbishing airfields and constructing defense works as well as normal field maintenance.

14. Thus, even before the Indo-Pakistani war broke out additional payroll, procurement, construction, and transportation costs may have added as much as \$100 million to Islamabad's military expenditures, which were budgeted at about \$700 million for FY 1972. The foreign exchange component of the military budget, however, did not necessarily increase, because Pakistani attempts to procure military equipment overseas were largely unsuccessful. While the People's Republic of China (PRC) supplied some military aid, payments are not scheduled to begin at least until 1974.

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15. The civil war brought a cutback in foreign economic aid commitments. In March, new aid extensions from the Western Consortium were stopped except for humanitarian aid to the East. The Consortium had pledged \$400 million in 1970 but committed only \$130 million⁽²⁾ before the civil war's outbreak. Nevertheless, Pakistan's foreign exchange reserves in November of \$215 million were about the same as a year earlier and higher than in February 1971. Despite a small decline in the two wings' combined foreign exports, Islamabad was able to increase reserves during the civil war because previously authorized aid disbursements continued at high levels, imports fell, and debt payments to foreign governments were suspended in May, saving about \$10 million monthly.⁽³⁾ Moreover Pakistan received at least \$40 million in economic aid disbursements from various Middle Eastern countries.

16. Despite rising military costs and declining aid commitments, West Pakistan's economy showed few signs of added strain on the eve of the war with India. Drought reduced wheat production from 7.3 million metric tons in FY 1970 (when Pakistan was a net exporter) to 6.5 million tons in FY 1971, but output and carryover stocks available in FY 1971 were sufficient to meet internal needs.⁽⁴⁾ Some increase in unemployment was reported as a few textile mills were forced to close, and prices on the Karachi stock exchange were down 18% since March. Otherwise, business seemed to be continuing as usual. The major industries, including cotton textiles, largely overcame the loss of sales to East Pakistan by expanding foreign exports. Prices in West Pakistan remained fairly stable. In conjunction with a demonetization of large currency notes in June, the government reduced currency in circulation by taxing large holdings and invalidating those apparently obtained illegally. The budget deficit was held down by new taxes and sharp cutbacks in development spending.

Economic Effects of the War with India

17. The full-scale war with India that began on 3 December lasted only two weeks, and additional military spending thus was probably not very large. Reduced supply costs resulting from Indian interdiction of sea and air routes to the East at least partly offset increased operational expenditures. Small military aid deliveries from the PRC and Middle Eastern countries during the war were provided either as outright grants or on easy credit terms. However, replacement costs of the equipment lost will be

2. Excluding aid for the Indus Basin Project, which is continuing. This aid amounted to \$30 million in FY 1970.
3. Islamabad announced a six-month moratorium on its debt to foreign governments -- about 55% of its total foreign debt. In October the unilateral moratorium was extended through January 1972 because creditor nations refused a request for debt rescheduling.
4. A December 1971 request to the United States for 300,000 tons of wheat reflected primarily Islamabad's reluctance to draw down private stocks and anticipated production shortfalls in FY 1972.

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considerable. Pakistan's military hardware at the war's outset probably was worth about \$800 million at current prices. As much as \$200 million worth of equipment was destroyed, captured, or otherwise expended by 17 December; the Pakistani military inventory in the East Wing was a complete loss.

13. India's blockade of Karachi virtually halted Pakistan's foreign trade for a short while and Indian bombing damaged Karachi's petroleum installations, but few other industrial sites apparently were hit. Preliminary estimates by Karachi officials put the repair costs for petroleum facilities at \$25 million. Reconstruction of these facilities could take about two years. Distribution disruptions led to some shortages of essential commodities, and rationing and price controls were instituted. But in general, daily economic activity was affected relatively little by the short war.

New Economic Situation

19. With the war's end and the breakaway of the East Wing, Islamabad lost a 55,000-square-mile area with about 75 million people (including the refugees in India). At the same time, it lost the poorest, most stagnant part of Pakistan and a growing claimant on foreign aid receipts. Living conditions have hardly improved in the East Wing for two decades, and in recent years Islamabad had been pressed by foreign aid donors to channel more assistance there.

20. Despite the war with India and loss of the East Wing, West Pakistan's economy remains essentially intact and has the potential for sustained economic progress, given political stability and continued substantial aid inflows. As a result of the impressive 50% increase in foodgrain production during 1966-70, the area is basically able to feed its population. West Pakistan also has a fairly adequate reservoir of entrepreneurial talent, a resource that is being augmented by returnees from the East. Except for the petroleum facilities in Karachi, most war damage can be quickly repaired.

21. Prospects for aid -- and economic development generally -- depend partly on Pakistan's policy orientation. The evidence to date suggests that the Bhutto government will be less conservative and more statist than the military government that preceded it, although it has yet to give a clear indication of how sweeping reforms will be. The new leadership already has enlarged government control of industry and is considering land and labor reforms, as well as measures for more equitable income distribution. Management of such firms as those of public utilities, iron and steel, engineering goods, cement, tractors, automobiles, chemicals, and rayon was taken over by the government in early January 1972. The industries affected account for about one-fourth of total industrial

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production, but not all firms in these fields were taken over. So far, the action stops short of complete nationalization, as it does not involve acquisition of the firms' assets, and the government has not yet moved to take over cotton textiles, the West's major industry and foreign exchange earner. The government also is seriously thinking about tax reform and better tax enforcement, which are urgently needed in agriculture and other sectors to mobilize domestic resources more effectively. President Bhutto, however, has assured the international community that foreign investment and contracts are not imperiled.

Export Prospects

22. Although some progress already has been made in redirecting trade, loss of East Wing markets probably will prevent any significant gain in West Pakistan's total exports in FY 1972 despite substantially increased sales to foreign customers. Restoration of any significant trade with Bangladesh is unlikely in the near future, and West Pakistan will be unable to replace all of the lost markets quickly. Trade with the East Wing, negligible at partition, increased rapidly behind the new country's tariff barriers, and by FY 1971 West Pakistan's interwing exports were about one-third as large as foreign sales. Food made up 33%, cotton and tobacco manufactures 20%, and raw cotton and tobacco 17% of sales to the East (see Table 2). Most of the remainder consisted of manufactured consumer goods and intermediate goods; capital goods accounted for only 7% of the total.

23. Redirecting trade will be helped by the fact that interwing exports consisted mainly of the same types of goods that West Pakistan sold in foreign markets, though items sold in the East sometimes were of lower quality. Some textiles previously sold to the East probably have been offered in local markets recently in place of higher-quality goods that can be exported. A few textile manufactures already have shifted their product mix in favor of higher-quality fabrics for sale abroad, and others probably will soon move in this direction. Food, particularly rice grown specifically for the East, will be difficult to export now because of its low quality and limited world markets. Islamabad currently has about 300,000 tons of rice that were destined for shipment to the East.

24. Prospects are mixed for promptly redirecting former interwing exports other than food and textiles. No problems are likely in selling raw cotton because of the established marketing channels and its demonstrated competitiveness in foreign markets. West Pakistan's raw and manufactured tobacco, on the other hand, are of inferior quality and may not be salable abroad in significant quantity. The small amounts of other foodstuffs, manufactured consumer goods, and industrial materials previously sold in the East probably can in large part be marketed abroad even though their

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Table 2

West Pakistan:
 Exports to the East Wing
 Fiscal Year 1971

	<u>Million US \$</u>
<i>Total</i>	144.5
	<u>Percent</u>
<i>Percent distribution</i>	100
Consumer goods	58
Food	33
Rice	17
Rape and mustard seed	8
Other food	8
Manufactures	25
Cotton piece goods	16
Tobacco	4
Drugs and medicines	3
Other consumer manufactures	2
Intermediate goods	26
Raw cotton	10
Raw tobacco	7
Cotton twist and yarn	4
Paper and paperboard	2
Other intermediate goods	3
Capital goods	7
Cement	4
Machinery and millwork	3
Miscellaneous	9

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quality generally is not up to world standards. West Pakistan has, in fact, considerably expanded its foreign sales of many of these goods in recent years.

25. On balance, we estimate that West Pakistan's foreign exports will rise appreciably in FY 1972 and 1973, just about offsetting the lost sales to the East. Total exports thus are expected to remain near the FY 1971 level of \$564 million (see Table 3). Although the 24% increase in foreign sales in FY 1971 to some extent reflects recovery from the previous year's decline, it did push foreign sales well beyond earlier levels. This rapid growth has continued into FY 1972, with foreign exports during July-November 1971 exceeding those of the comparable 1970 period by 5%. Since the rupee is pegged to the dollar, continuing export performance will be helped by the recent currency revaluations by such customers as Japan and West Germany. We believe that foreign exports will reach some \$500 million in FY 1972 - roughly 20% more than foreign sales in FY 1971 -- and that foreign and interwing exports combined therefore will approximate \$560 million. If the government maintains imports of essential raw materials and fuels, a further increase in foreign exports of 10% to 15% is estimated for FY 1973, raising total earnings to about \$550 million - \$575 million.

Table 3

**West Pakistan:
Trends in Foreign and Interwing Exports a/**

<u>Fiscal Year</u>	<u>Foreign</u>	<u>To East Wing</u>	<u>Total</u>	<u>Million US \$</u>
1960	160	60	220	
1966	253	125	378	
1967	281	137	418	
1968	346	128	474	
1969	357	141	498	
1970	338	174	512	
1971	420	144	564	
1972 b/	500	60	560	
1973 b/	550-575	Negl.	550-575	

a. Based on customs data. The official exchange rate of 4.76 rupees to the US dollar overvalues the rupee by about 100%. The rupee thus has been converted to dollars at the rate of 9.5 to 1 in valuing interwing trade.

b. Projected.

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CONFIDENTIALForeign Exchange Reserves

26. Islamabad apparently has control of Pakistan's foreign exchange reserves, officially reported as \$180 million in late January 1972, or the equivalent of about 3 months' foreign and interwing imports at FY 1971 levels. It already has transferred hard currency deposits from some Western banks to the PRC and elsewhere, presumably to take them out of jurisdictions where courts might later award a share to Bangladesh. Moreover, the government has demanded that wealthy Pakistanis repatriate funds held abroad, which one source estimates at \$200 million. To show that it means business, Islamabad has impounded the passports of the families that largely control finance and industry and has threatened harsh punishment if the funds are not brought back. Only about \$25 million, however, had been repatriated by mid-January. To further reduce pressure on its foreign reserves, the government probably will insist that Bangladesh assume debts that arose specifically from aid programs for the East Wing. Dacca, however, may be willing to assume part of the debt only if it receives a share of Islamabad's foreign exchange reserves -- and perhaps not even in that circumstance.

Foreign Economic Aid

27. The outlook for economic aid -- including debt renegotiation -- is highly conjectural, but present indications are that gross receipts in FY 1972 will be considerably smaller than the FYs 1970 and 1971 average of about \$430 million. Even if the partial unilateral moratorium on debt service payments continues through FY 1972⁽⁵⁾ (or if the Western Consortium officially provides comparable relief), net aid receipts this fiscal year probably will approximate only \$200 million, compared with about \$340 million in FY 1971.

28. Although the suspension of new aid extensions continues, West Pakistan has been able to draw on previously authorized programs with an estimated value of roughly \$900 million when the fiscal year began. Of the available commodity aid of some \$100 million, at least half probably already has been drawn, and the remainder will soon be exhausted. The remaining \$800 million in the assistance pipeline consisted mostly of World Bank, US, West European, Chinese, and Soviet credits for development projects. Considering the general nature of these projects and the disruptive effects (including budget strains) of the civil war and the fighting with India, we believe that development aid receipts will reach only about \$200 million in FY 1972. Thus, unless new assistance becomes available -- especially new

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commodity aid that can be used quickly without making financial demands on West Pakistan itself - gross aid receipts this fiscal year seem unlikely to exceed about \$300 million. One-third of this amount is expected to be offset by debt service payments to private creditors and international agencies, which are not affected by the unilateral payments moratorium.

29. New aid extensions for FY 1972 are of course a possibility, considering Islamabad's financial plight, and the government could facilitate them by promptly laying out an economic program that shows specific requirements. But provision of additional aid this fiscal year apparently would require action by individual countries rather than the Consortium. Although the Consortium is scheduled to confer in late February on the debt question, a meeting on aid pledges probably will not take place until spring or summer.

Import Capacity

30. The foregoing estimates and assumptions point to a sharp reduction in West Pakistan's imports of civilian goods in FY 1972. Only a moderate decline is indicated, however, if, for example, Islamabad further reduces its foreign reserves by \$50 million, or 30%, and receives new commodity aid of similar magnitude. In FY 1973, some improvement in import capacity is in prospect, but full recovery to the FY 1971 level is improbable unless aid donors are extremely generous. The projections underlying these conclusions are summarized in the following tabulation:

	<u>Million US \$</u>	
	<u>FY 1972</u>	<u>FY 1973</u>
Exports	560	550-575
Receipts from invisibles	100	100-125
Gross aid receipts (excluding military aid)	300	450 a/
 Total receipts	 960	 1,100-1,150
 Less: Debt service payments	 110	 130 a/
Payments for invisibles (including defense imports not financed by foreign aid)	200	220-270
 Plus: Drawdown of foreign reserves, July-December 1971	 40	
 Equals: Import capacity for civilian goods, assuming no further drawdown of reserves	 690	 750

a. Assumed.

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31. At the projected value of \$690 million, West Pakistan's imports in FY 1972 (see Table 4) would be about one-sixth lower than in FY 1971. Imports in FY 1973 could amount to some \$750 million -- about 10% short of the value in FY 1971 -- if gross aid receipts were restored to the FY 1971 level of about \$450 million. Adjustment to reduced levels of import capacity in FYs 1972 and 1973 may require increased government controls over private purchases abroad, but the restrictions should not be severe.

Table 4

West Pakistan:
Trends in Foreign and Interwing Imports a/

<u>Fiscal Year</u>	<u>Foreign</u>	<u>From East Wing</u>	<u>Million US \$</u>
1960	380	38	418
1966	605	68	673
1967	761	76	837
1968	699	82	781
1969	640	91	731
1970	690	96	786
1971	757	85	842
1972 b/	650	40	690
1973 b/	750	Negl.	750

a. Based on customs data. The official exchange rate of 4.76 rupees to the US dollar overvalues the rupee by about 100%. The rupee thus has been converted to dollars at the rate of 9.5 to 1 in valuing interwing trade.

b. Projected.

32. So far, the cutback in imports has fallen mainly on capital goods, which made up nearly half of total imports in FY 1971. During July-November, capital goods imports declined by 32% from the same period in 1970 compared with a 6% decline in consumer goods imports. Capital goods probably will continue to bear the brunt of the import constraint through much of 1972, if not longer. Capital goods imports are dropping because investment demand in both the private and public sectors is weak. Private business has been holding back because of prolonged political uncertainty and because there still is unused industrial capacity. Public investment, including foreign aid projects, has been depressed by war-related disruptions and budget constraints.

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33. Imports of consumer goods and of inputs for consumer goods production will drop further unless Islamabad obtains substantial amounts of additional commodity aid. Commodity aid has financed a large part of imports of food and other consumer goods which represented one-sixth of total imports in FY 1971. Fertilizer imports have been cut back sharply so far in FY 1972, a move that will depress agricultural output unless improved weather compensates for it. Clearly, commodity aid will be Islamabad's first priority when new assistance becomes available.

34. Islamabad probably will seek to rebuild its arms inventory gradually with more modern and expensive weapons than were lost, and military imports are likely to increase moderately over the next year or two. Large-scale hard currency purchases of arms are unlikely, not only because they would require a heavy diversion of resources away from economic development but also because they could discourage new economic aid commitments from Western donors. As in the past however, the PRC probably stands ready to provide substantial amounts of equipment at concessionary prices under long-term credits.

Overall Economic Prospects

35. In view of its export and import problems, we estimate that West Pakistan will suffer a small decline in overall economic output in FY 1972. Setbacks will be most pronounced in industry and construction. Loss of East Wing markets will depress output in certain industries despite generally successful efforts to redirect trade. The textile industry, for example, sold about 23% of its fabric production to the East Wing in FY 1970 and needs time to adjust fully to the new situation. Other industries – such as cement and cigarettes – probably will also be hurt by the cutoff of sales to the East. Activity in the engineering and construction industries will slacken because of weak investment demand, with construction volume probably falling off substantially. In addition, firms that experienced management upheavals when the government took control are likely to have lower output this year than last.

36. Agriculture will be less affected by the recent crisis, but a lack of rain has put an early damper on prospects for a good wheat harvest. The loss of the East Wing markets for rice will likely result in reduced output in FY 1973. Reduced imports of fertilizers and pesticides could have further adverse effects on production.

37. Setbacks in industry and agriculture obviously will impact on the rest of the economy. Unemployment already has risen in some areas and will rise further. Consumer spending is expected to decline this year. Private investment will be slow to recover so long as balance-of-payments strains persist. Increased budgetary problems seem inevitable.

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38. Longer-term growth prospects depend mainly on Bhutto's policies and foreign countries' response to West Pakistani needs. Western nations are likely to resume aid extensions and negotiate a debt relief program if, as seems likely, Bhutto eschews large-scale rearmament and radical economic policies. Still, aid receipts and export growth through FY 1973 may only help Islamabad to restore rather than further expand earlier import levels. Political and economic moderation is also needed if confidence is to be restored to domestic businessmen and farmers.

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